Belarus

Financial Sector Assessment

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The Financial System Assessment (FSA) is based on the work of the joint IMF-World Bank Financial Sector Assessment Program (FSAP) Update that visited Belarus from September 17, 2007 to September 30, 2008.¹ The principal objective of the FSAP Update was to assist the authorities in evaluating progress, assessing potential vulnerabilities of the financial system, and determining future challenges. Following reviews within the IMF and the World Bank, an Aide-Mémoire, Technical Notes on a detailed assessment of compliance with BCP Principles of Banking Supervision, summary assessment of compliance with the IOSCO principles, and access to finance, and background notes on stress-testing and the insurance sector have been submitted to the authorities.

This report provides a summary of the main findings and key recommendations.

I. OVERALL ASSESSMENT

1. **The Belarusian financial sector has weathered recent strains well to date, but faces mounting challenges.** The latest bank performance indicators remain satisfactory, and the relatively high aggregate capital adequacy ratio of banks provides some cushion for unexpected losses. However, in the context of a much less forgiving external environment and a slowdown in Russia and other main trading partners, the financial system has become particularly vulnerable to credit, foreign exchange, and liquidity risks. Measures taken by the authorities since the FSAP mission since late-2008, particularly the adoption of a blanket guarantee on household deposits in early November 2008, have helped to maintain systemic stability.

2. **Overall, the supervisory framework for banks has significantly improved since the 2004 FSAP, though concerns remain in some crucial dimensions.** The new Banking Code was passed in 2006, and secondary legislation is updated on a regular basis. While the majority of recommendations made by the 2004 BCP assessment have been adopted or are in process of implementation, the independence of the National Bank of Republic of Belarus (NBRB) Board and bank supervisory processes continue to pose operational and reputation risks. As well, the capital adequacy framework needs substantial improvement to more accurately reflect the structure of the banking sector. Supervisory actions could be significantly enhanced by imposing adequate corporate governance requirements for banks.

¹ The mission comprised Michael Edwards (Mission Chief, World Bank), Vassili Prokopenko (Deputy Mission Chief, IMF), Michaela Erbenova, Yulia Makarova (all IMF), Michel Noel and Alexander Pankov (all World Bank); and Fernand Naert, Donald McIsaac, Michael Boss, and Joerg Genner (all outside experts). Mr. McIsaac undertook a desk review of the insurance regulator and supervisory regime. The Accounting and Auditing ROSC assessment mission, led by Luc Cardinal with Andrei Busuioc, was conducted in parallel to the FSAP mission.
3. Despite numerous achievements, sound and sustainable financial sector development in Belarus remains constrained by pervasive government influence. Significant state ownership of banks and non-financial enterprises, the large share of bank lending under various state programs, and numerous administrative controls have reduced the incentives for banks to carry out effective risk assessment and management, and allowed many nonviable enterprises to survive. To better ensure the long term viability of the banking sector, the authorities are urged to overhaul the existing directed lending mechanisms.

4. Government recommended and subsidized lending schemes are complex and widespread, crowding out the allocation of financial resources to the private sector. A large number of schemes and the lack of transparency in their allocation undermine bank competition, magnify sectoral risk concentrations and may ultimately yield higher borrowing costs for the real sector. The existing system does not provide incentives for the restructuring of state-owned enterprises (SOEs). Risk-based pricing for all enterprise loans is further distorted by interest rate ceilings, which impede both effective risk assessment and strengthening of management capacities in Belarusian banks.

5. These directed lending schemes are not only pervasive, but also carry high direct and indirect costs to Belarus. The state has repeatedly recapitalized the largest four banks, particularly Belarusbank and Belagroprombank in recent years. The cost of these recapitalizations averaged 1 percent of GDP per year, for a total cost of the equivalent of around US$1.7 billion in the last eight years.

6. To mitigate these costs and better ensure the long-term viability of the banking sector, the authorities are urged to overhaul existing directed lending mechanisms. Establishing a dedicated agency to fund public sector lending outside the banking sector would be a preferable instrument for achieving the authorities’ development objectives. All existing guaranteed loans and associated government funding in the four largest state-owned banks (SOBs) should be transferred to this agency within an agreed time. Going forward, this agency would be the exclusive source of funding for state development programs. Adoption of such a model would allow for the more efficient allocation of credit, the modernization of banks’ governance, and pave the way for the entry of strategic investors.

7. Bank lending outside the recommended loan schemes has grown sharply in recent years, giving rise to new challenges. Credit and liquidity risks are the main sources of vulnerability facing Belarusian banks. While the financial soundness indicators reported are satisfactory, there are significant concerns with the accuracy of data, especially loan-loss provisions. Banks’ aggregate capital adequacy ratio is overstated by 2–3 percentage points
due to improper loan classification and the persistent under-provisioning of loans, though stress tests results suggest that the banking system is resilient to a wide range of plausible shocks.

8. **Sound crisis preparedness system should be established to deal with problems that may arise in the banking sector.** The NBRB, the ministry of finance (MOF), and the Deposit Insurance Fund (DIF) should formalize a crisis management framework, including practical guidelines and information exchange routines. A documented policy for provision of emergency liquidity assistance should be developed, which should include broadening the list of acceptable collateral. In parallel, the remedial action framework should be strengthened.

9. **The regulatory and supervisory regime for non-bank financial institutions is not supportive for the development of insurance and securities markets.** Both insurance and securities market regulators lack clear mandates, operational independence, and adequate resources. Importantly, the insurance sector faces a number of critical constrains on the types of coverage that may be offered, the rights of clients to choose insurers, and the application of reinsurance. The framework for protection of minority shareholders and takeover provisions are weak.

10. **Measures should be taken to broaden access to finance, which is low by regional standards.** The regulatory framework should be made more conducive for lending to micro-, small-, and medium-sized enterprises (MSMEs) by adopting a special licensing regime to foster the establishment of microfinance institutions. Additionally, the NBRB should modify its guidelines for simplified approval procedures to encourage the provision of banks’ financial services to this underserved segment.

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**Summary of Key FSAP Update Recommendations**

1. Establish a dedicated agency to receive all guaranteed loans and associated deposits from public banks
2. Strengthen independence of the NBRB Board and bank supervisory processes
3. Adopt a joint NBRB/MOF crisis management framework and operational guidelines
4. Document the framework for emergency liquidity assistance
5. Revise the loan classification and provisioning requirements to reflect the entire balance of nonperforming loans
6. Engage a qualified experienced consultant to assist the Belarusbank privatization working group
7. Move government deposits from banks to the NBRB
8. Offer SOE deposits to banks on a competitive basis
9. Abolish the obligatory re-insurance requirement for local insurance companies
10. Eliminate the obligation of SOEs to acquire insurance from state-owned companies

II  OVERVIEW OF THE FINANCIAL SYSTEM

A.  Macroeconomic Background

1. **The Belarusian economy performed strongly until late 2008.** Annual real GDP growth was around 10 percent in 2004–2007, and despite the unfavorable energy import price agreement with Russia, in effect from January 2007, economic performance remained robust until October 2008 (real GDP growth was 10.3 percent in the first half of 2008, Table 2). The authorities started to gradually tackle structural reforms, including privatization in the banking, telecommunications, and manufacturing sectors.

2. **Since the time of the FSAP Update mission in the autumn of 2008, the macroeconomic outlook has deteriorated sharply.** GDP is projected to decline by 4 percent in 2009, reflecting a significant fall in exports to Russia and other commonwealth of independent states (CIS) as well as a lower domestic demand. Key sources of external financing, including FDI, trade credit, and bank borrowing, dried up in late 2008, leading to a significant pressure on reserves.

3. **The authorities responded by tightening macroeconomic policies and devaluing the rubel in January 2009.** Fiscal policy was significantly tightened, with smaller wage increase and a commitment to a balanced budget. Monetary policy was also tightened, with a significant increase in interest rates. The January devaluation was accompanied by a change in the exchange rate regime, from a band vis-à-vis the U.S. dollar to a multi-denominated currency basket comprising the U.S. dollar, the Russian ruble, and the euro. These policies were supported by the Stand-By Arrangement approved by the IMF Board in January 2009.

B.  Financial System Structure

4. **The financial system in Belarus is dominated by banks.** As of June 2008, there were 28 licensed commercial banks, 20 of which were authorized to collect deposits from individuals. There were 5 state-controlled banks (down from 6 in 2004), 7 private banks owned by residents, and 16 foreign owned banks. Concentration among commercial banks is relatively high. Six banks, four of which are state-owned, dominate the market with a combined market share of around 80 percent of the total assets. Since 2004, assets, deposits, and credit have increased rapidly. Total assets of the banking sector increased by
37.8 percent in 2007, to about 45 percent of GDP (from about 28 percent in 2004). Assets of state-controlled banks represent 76 percent of total assets, while those of foreign-owned banks are about 20 percent of total assets as of June 2008.


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<tr>
<th>Number of Assets (RBL trln.)</th>
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<td>6.3 8.0</td>
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<td>1.3 2.1</td>
<td>7</td>
<td>1.9 2.4</td>
<td>6</td>
<td>1.7 1.7</td>
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<td>4.4 5.6</td>
<td>16</td>
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<tr>
<td>State-owned</td>
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<td>16.6 25.5</td>
<td>5</td>
<td>23.7 30.0</td>
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<td>32.9 34.2</td>
<td>5</td>
</tr>
<tr>
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<td>23</td>
<td>0.6 0.8</td>
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<td>21.8 33.6</td>
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<td>30.6 38.7</td>
<td>50</td>
<td>43.8 45.6</td>
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Sources: NBRB and Ministry of Finance.

1/ The financial sector in Belarus also includes some leasing companies and securities dealers, but these institutions are very small and there are no precise data available on their numbers and size.

5. **With the exception of insurance companies, non-bank financial institutions are almost non-existent.** There are neither securities companies, nor private pension funds. The share of leasing, which is not a licensed activity in Belarus, was only 1.1 percent of total bank loans at end-2007. Around one third of leasing companies are controlled by banks.

6. **The insurance sector is characterized by few assets, a high degree of concentration through state ownership, as well as a lack of competition.** As of January 2008, there were 23 insurance organizations in Belarus, representing 2 percent of total assets of the financial sector (0.9 percent of GDP) and 4 percent of the capital of the financial sector (0.3 percent of GDP). Out of 23 insurers, eight are public institutions and nine have foreign capital. Insurers’ financial performance in 2007 improved compared to 2006, when five insurers had made losses. The state-owned insurance market leader, Belgosstrakh, held a market share of 59.4 percent as of July 1, 2008.

7. **The securities markets in Belarus are relatively undeveloped.** At the beginning of 2008, the value of all securities (debt and equity) in circulation was equivalent to around US$8.2 billion (18 percent of GDP), most of which are government securities. The volume of equity trades totaled US$2.6 billion equivalent in 2007. However, significant volumes of over the counter transactions through the sale of state-owned enterprise shares have been traded in the past. With regards to private debt, there were only 59 issues of corporate bonds for about US$203 million in 2007.
Belarus. Indicators of the Banking Sector Structure

**Total Banking Assets to GDP in Belarus**

- Total Banking Assets to GDP, 2007

**Asset Share of State-Owned Banks, 2006**

**Asset Share of Foreign-Owned Banks, 2006**

**Financial System Structure, 2007**

- In Percent of Total Assets

Source: NBRB, ECB, EBRD and staff estimates
III. FINANCIAL SECTOR PERFORMANCE AND VULNERABILITIES

A. Financial Soundness Indicators

1. **Financial soundness indicators for the banking sector appear satisfactory.** The capital adequacy ratio has declined in recent years and it stood at 16.5 percent in September 2008, although it seems overstated due to inadequate loan loss provisioning. However, the ratio of reported NPLs to gross loans stood at less than 1 percent at mid-2008 (from about 2 percent in 2005), partly reflecting the overall rapid credit growth, which was nearly 50 percent annually in nominal terms in recent years. The profitability and liquidity indicators are also satisfactory. At end-September 2008, return on equity stood at 12 percent and the return on assets at 1.7 percent. Liquidity has also declined in recent years, but stood at 20.7 percent at end-September 2008.

2. **Despite satisfactory reported figures, banks’ ability to absorb risks is likely overstated due to inadequate loan classification and provisioning.** The loan loss provisioning regime discourages the early recognition and write-offs of impaired assets. The information on loan quality is significantly distorted both by the current loan classification and provisioning practices as well as a high share of loans guaranteed by the government that are classified as standard.

B. State Influence in Lending

3. **The state influence on the banking sector has a very wide scope, distorting competition among banks, inhibiting financial sector development and constraining further market deepening.** With one exception, all major banks are government-owned or controlled. The nine largest Belarusian banks are authorized to participate in the state programs, which generally involve lending to priority sectors, projects, and individual companies on preferential terms. Loans under the state programs are recommended rather than being mandatory, via President or Government decrees and resolutions. In 2008, there were up to 30 such programs in place.

4. **Most of the recommended loans are distributed by the two largest state-owned banks and are often guaranteed by central or local governments.** Most of the recommended loans (about 90 percent) are distributed by Belagroprombank and Belarusbank. In the first half of 2008, the newly extended loans under the state programs reached up to 40 percent of all newly extended loans in one of the largest banks. More than half of the newly issued recommended loans were directed to agriculture and 25 percent to individual and enterprise-funded housing construction for residents. At end-June 2008, government guaranteed loans made up about a fifth of all bank loans to the economy (an equivalent of about US$ 4 billion). In the past three years, loans guaranteed by the local
governments increased faster than loans guaranteed by the central government. Often, the debtors are charged subsidized interest rates.

5. **Starting from January 2009, the system of government guarantees will significantly improve banks’ position, but the risks stemming from the outstanding stock of guarantees will remain.** Under the current rules, only principal amounts are guaranteed and the guarantee is conditional on banks’ exhausting all legal means to recover the debt from a borrower prior to calling on the guarantee. Moreover, the guarantee can be called only within six month after the maturity of the loan. The new system makes central and local government guarantees irrevocable, unconditional, and requires their immediate execution (effectively within 20 days from a missed payment).

6. **The state-controlled banks extend the bulk of recommended loans under the state programs and benefit from certain advantages.** The banks’ funding is bolstered by short term credits from the central bank and short-to-medium term government deposits. In some cases, government deposits are linked to particular lending schemes; in other cases deposits are simply placed by the MOF. Total government deposits in the four state-controlled banks amounted to about 20 percent of total deposits. Until February 2008, the state-owned enterprises were required to have only one account with one bank, giving the banks servicing their loans a competitive advantage. The liberalization in this area represents a welcome step forward. The dominant state-controlled banks have also received periodic recapitalizations, straining fiscal policy. Since 2000, the government recapitalized the largest four state-controlled banks on an annual basis.

7. **The system in Belarus impedes the efficient allocation of financial resources to productive private sector projects.** A large number of schemes and lack of transparency in their allocation distort competition, undermine credit underwriting, and may result in higher costs of funding for the real sector. The system does not provide incentives for the envisaged real sector restructuring. Risk-based pricing of a large share of loans is distorted by lending rate caps and recommendations limiting banks’ profitability and introduction of modern risk management methods. Sectoral concentrations of loan books of the largest banks is high, exposing these banks to additional risks.

8. **A number of measures are recommended to mitigate the effects of state influence in lending.** It is recommended that: (i) the government establish a new development agency to receive all existing guaranteed loans and associated state funding from the four largest state-owned banks; (ii) all deposits of the state budget be gradually directed to the NBRB and SOE deposits be offered to banks on a competitive basis; and (iii) an experienced third-party is engaged to assist the Working Group on the privatization of Belarusbank in the preparation of a medium term strategy for the transformation of state-controlled banks ahead of privatization.
IV. FINANCIAL REGULATION AND SUPERVISION

A. Banking Sector

1. Since the 2004 FSAP, significant steps have been undertaken to improve the regulatory and supervisory frameworks for banking supervision. A new banking code was passed in 2006, and secondary legislation is updated on a regular basis. The General Directorate for Banking Supervision (GDBS) of the NBRB, which is responsible for bank supervision, is moving from a compliance-based to a risk-based supervision at an appropriate speed. It applies an appropriate mix of off-site analysis and on-site inspections. However, corporate governance remains a serious concern, as there is no requirement for a suitable fit and proper test for banks’ supervisory board members. The GDBS’ major challenges will be the implementation of consolidated supervision, the introduction of international financial accounting standards for the banking sector, and enhancing risk management in the banks.

2. Nevertheless, the capital adequacy framework in Belarus needs substantial improvement to more accurately reflect the unique structure of the banking sector. The framework prescribes a standardized approach for credit risk, which is by far the most important risk facing Belarusian banks. It aligns capital requirements closely to the economic risk by differentiating risk weights and recognizing credit risk mitigation techniques. Risk weights are applied to both on- and off-balance sheet items. Currently, capital requirements are applied only a solo basis only, although the GDBS has started implementing capital requirements on a consolidated basis and is currently assessing the potential impacts on the banks.

3. The introduction of IFRS will have a significant impact on capital adequacy and disclosure issues have arisen. It is estimated that the application of the IFRS would lead to differences in the capital and/or assets for banks, differences that result mostly from the accounting for interest rate subsidized loans. If banks would have been required to report under IFRS in 2007, several would have needed to increase capital. GDBS is aware of the necessity to introduce prudential filters for regulatory capital once the IFRS is implemented. However, distinct risk management functions are still limited within banks. In addition, some concerns remain with regard to disclosure, both by the GDBS and by banks towards the introduction of IFRS. IFRS standards are to be applied by banks beginning in 2009. However, banks have the discretion to publish their annual reports based on either IFRS or national accounting standards, which differ significantly with regards to, inter alia, the treatment of interest rate subsidies and the application of loan loss provisioning practices. Further, banks will be permitted to determine to what extent disclosure can be made on an IFRS basis. To strengthen confidence in the banking sector, this reporting asymmetry should be eliminated.
B. Insurance Sector

4. **The supervision and regulatory framework for the insurance sector needs to be enhanced further.** The insurance supervisor within the Ministry of Finance is responsible for the supervision of the insurance industry. A significant codification of the insurance regulatory system was issued by Presidential Edict in 2006 and further amendments have been issued. The regulatory framework includes many of the necessary requirements. For example, regulations address minimum initial capitalization, solvency margins to be maintained and risk retention limits to ensure that companies use reinsurance to protect against excessive exposure to a single risk. Solvency rules implemented by the Edict follow the standards of the EU. In addition, insurance companies are required to follow investment management practices for the safety of investments as well as for the matching of assets and liabilities by yield and term to maturity. There are quantitative and qualitative limits on insurers’ portfolio in order to achieve diversification. On-site inspections are conducted on a rotating basis, and approximately 20 inspections are conducted annually. However, the regulatory system lacks measures to promote sound governance. Actuarial services are not available in Belarus, affecting the computation of insurance prices and establishment of reserves.

5. **The majority of the premia collected, close to 90 percent, flow to state-owned or controlled companies.** Privately held companies may obtain licenses, but their scope of business is severely restricted. For example, private companies are not authorized to sell policies in the compulsory classes of insurance, which are reserved for state-owned companies. Additional restrictions apply, for example, SOEs can buy insurance only from state owned insurers and foreign-owned insurers are further restricted in their activities. A new state-owned reinsurance company was launched in 2006 with a legal monopoly. All local companies must cede a significant proportion of their excess reinsurance to this new company, which has the exclusive right to access the international market for reinsurance.

C. Securities Markets

6. **Over the past 15 years, oversight of the securities market has shifted numerous times, negatively impacting the development of the sector.** Since 2006, the Securities Department (SD) of the Ministry of Finance has been responsible for the supervision and regulation of the Belarus securities market. Deficiencies in the legal, regulatory and supervisory framework hamper sound development of the securities market over the medium-term. There are no laws and regulations governing Self Regulatory Organizations (SROs) and investment funds.

7. **The SD lacks clear responsibilities, powers, operational independence and financial autonomy.** In particular, this includes its ability to carry out: (i) a determination of the ultimate controllers (UCs) of regulated entities and supporting economic, fiscal and
criminal background checks of these UCs; (ii) the consolidated supervision of regulated entities; (iii) the supplementary supervision of financial conglomerates; and (iv) supervision of securities settlement systems in collaboration with the NBRB. The SD also lacks operational independence and financial autonomy. Its salaries structure is not adequate to attract and retain staff with private market experience. As the market develops, staffing will be insufficient in the areas of licensing, off-site and on-site supervision, market supervision, and enforcement.

V. FINANCIAL SYSTEM SAFETY NET AND BANK RESOLUTION FRAMEWORK

A. Crisis Preparedness and Coordination

1. **Belarus needs to enhance the crisis prevention framework and establish prior coordination mechanisms amongst all agencies involved.** The crisis prevention framework needs to be able to address future challenges that may arise due to the privatization of state-controlled banks, particularly home-host supervision challenges. Effective crisis resolution requires swift and coordinated action that must be planned ahead. Coordination arrangements, clear rules and procedures for crisis management, and information exchange need to exist amongst the MOF, the NBRB, and the Deposit Insurance Fund (DIF). Arrangements must include the MoF due to a possibility that problems in a systemic institution may require the use public funds to prevent wider economic disruption. Memoranda of understanding are often used in addition to laws to deal with defining the authorities’ roles and powers as well as practical arrangements for information exchange. In addition, authorities need to develop a “crisis manual,” including practical guidelines for crisis management, forms for coordination, information sharing, and communication between authorities.

B. Emergency Liquidity Assistance

2. **The policy and operational framework for NBRB’s role as Lender of Last Resort needs to be formalized, although a number of instruments for monetary policy operations could be used for as its basis.** This framework should include the circumstances and categories of institutions that could get emergency liquidity assistance (ELA) and the terms and conditions for granting ELA. Emergency liquidity is typically given to a solvent institution against adequate collateral, but should also carry a punitive rate of interest to minimize moral hazard. There is also a need to draft an internal NBRB manual with practical procedures to ensure: (i) the timely availability of the necessary information on liquidity, solvency and systemic importance of the institution in problems; (ii) the criteria for expanding the list of eligible collateral in the event the existing stock of collateral is insufficient; (iii) other terms and conditions, such as loan maturity and interest rate principles; and (iv) specific conditions to be imposed on the bank’s activities, such as increased supervisory oversight or limitations of certain risky activities.
3. **The available collateral for ELA is relatively limited.** The list of eligible collateral is identical for both standing facilities and ELA. As of June 2008, banks held short- and long-term government securities of BYR 2,566 billion (about US$ 1.2 billion), BYR 520 billion of short-term NBRB securities and BYR 53 billion of bank bonds eligible as collateral for the central bank. Thus, the total potential collateral available in circulation was only about BYR 3.1 trillion or 6.2 percent of banks’ assets. The share of eligible collateral in banks’ assets has fallen from about 9 percent in January 2007 to 6.1 percent in June 2008 largely as a result of rapid credit growth. However, not all government securities are liquid, as some were issued at below market rates.

**C. Deposit Insurance**

4. **The new law on deposit insurance will level the competitive playing field across the Belarusian banks.** The law was passed in July 2008 and will become effective in January 2009. It represents a clear improvement over the current set of legislation that covers a very complex system of deposit insurance. In particular, the law: (i) treats state and non-state owned banks equally; (ii) treats foreign and local currency deposits equally, thereby reducing the incentives for dollarization; (iii) regulates relations of compensation of bank deposits by a specially created legal entity—the DIF; (iv) makes the membership of the DIF mandatory; and (v) covers only household deposits.

**D. Remedial Action Framework**

5. **Since the 2004 FSAP, the authorities achieved progress towards building an efficient bank resolution process in Belarus.** An effective bank resolution framework is of crucial importance in Belarus, given its rapidly growing banking sector and envisaged bank privatizations. Since the 2004 FSAP, a new Banking Code has been passed and new supervisory procedures have been implemented, as evidenced also by the BCP assessment.

6. **The NBRB has a wide range of necessary powers to address a bank in crisis.** These include a request that a bank implements measures for financial rehabilitation, including: revision of its asset structure, request removal of bank managers, request shareholders to increase bank capital, temporarily suspension of a banking license or particular activities for up to 1 year, ban on opening branches or establishing organizational

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2 See the List of eligible collateral (“Ломбардный список ценных бумаг”) at: http://www.nbrb.by/mp/LombList/. Besides the MOF and the NBRB securities, also bank bonds issued on the basis of President decree No. 537 from August 28, 2006 are accepted if listed on Belarus Stock Exchange. The list can be expanded upon a decision of the NBRB Board to other bank bonds provided these would be listed on the Belarus Stock Exchange.
units and license revocation. The NBRB is entitled to change values of prudential requirements for an individual bank, commit a bank to temporary management by the NBRB (for up to 6 months) or appoint temporary administration (for up to 18 months with a possibility to prolong it to a maximum of 30 months). Temporary administration at failing banks has been imposed twice in the recent past. The Banking Code gives NBRB the powers to use preventive measures when bank’s actions may lead to insolvency or endanger the interests of its depositors and other creditors.

7. **Nonetheless, additional measures are necessary to improve the remedial action framework.** Efforts should be taken with regards to shortening the process for insolvency and bankruptcy proceedings of credit institutions, which currently creates a prolonged period of legal uncertainty; considering eliminating the powers of the court to void the supervisor’s decision to withdraw a banking license, and granting NBRB with the powers to stop dividend payouts to prevent further weakening of a bank’s financial condition in times of stress and ensures that bank owners do not derive undue benefits.

VI. DEVELOPMENTAL ISSUES

A. Capital Markets

1. **Recently, authorities have taken a number of steps to stimulate the development of the domestic securities market.** The authorities have lifted the ban on the trading of shares that were distributed to the public under the mass privatization program. They have also adopted a trade concentration rule, requiring all equity trades to take place on-exchange, thereby creating conditions for increasing liquidity on the Belarus Currency Stock Exchange (BCSE). Measures have also been taken towards creating tax incentives for the development of the securities.

2. **The authorities should take further measures to broaden access to the market.** Firstly, the State Property Committee should accelerate their existing privatization program by offering shares in SOEs through open tender, simultaneously offering additional SOE share tranches on the BCSE. Second, the MOF should design and implement a plan to strengthen government debt management with the objective to develop a domestic government bond yield curve that can be used as a benchmark for the pricing of non-government debt securities.

3. **Authorities should improve the legal and regulatory framework covering the protection of minority investor rights and the conduct of takeover bids.** Regulated entities are not required to disclose their UCs, as part of the licensing process or on a continuing basis. There are no regulations requiring issuers to maintain a list of insiders and to communicate this list to the SD. Although no lists of insiders are maintained, joint-stock companies shall prepare lists of affiliated parties. There are no regulations requiring the establishment of independent compliance and risk management functions by regulated
entities. “Know your client” regulations do not require regulated entities to assess the level of financial literacy and the risk appetite of their clients. Regulated entities are also not required to trace the UCs of their clients. The MOU between the SD and the NBB does not cover the exchange of confidential information gathered in the course of their supervisory duties.

4. **Authorities should work towards achieving broad compliance with International Organization of Securities Commissions (IOSCO) Principles.** Meeting international standards of securities regulation and supervision would contribute greatly to integrating the securities market into the international capital market.

B. **Insurance**

5. **Given established plans for the development of the insurance market in 2006-2010, authorities will need to make many changes to achieve their goals.** In 2006, authorities established targets for the development of the market in 2006-2010, through the expansion in voluntary purchases of insurance. The vast majority of the insurance premia collected relate to mandatory motor liability insurance coverage. The plan calls for a 300 percent increase in the premia paid for non-life insurance purchased on a voluntary basis and 500 percent increase for life insurance. To meet these ambitious objectives many changes will be necessary. Currently, amounts paid out in claims on mandatory insurance total less than 50 percent of the premiums collected, while in a mature market the claim ratio for non-life insurance is about 80 percent. The public will not be easily attracted to purchase insurance unless it is perceived that the prospect exists of a reasonable payout on claims.

6. **Given the tightly-controlled insurance market, including the recent establishment of the state-owned reinsurance company, it will be difficult to implement far reaching reforms.** Private insurers should be granted more freedom in the market. Once adequate capital standards are established, the private sector must be able to offer mandatory insurance. For example, in most countries motor third party liability insurance is mandatory, but can be offered by private companies. The recent establishment of the state-owned reinsurance company is an obstacle to the development of the insurance market. The state-owned reinsurance company may not be able to provide the same quality of service as well established reinsurance companies. In addition, a gradual increasing proportion of each company’s reinsurance must be offered to the state-owned reinsurance company. Thus, it may be possible that within a few years, all reinsurance flows to the state reinsurance company, impeding the development of the insurance market.

C. **Access to Finance**

7. **Despite the recent rapid expansion of credit and deposits in Belarus, access to finance remains limited.** The level of financial intermediation remains one of the lowest
among the CIS countries, with a credit-to-GDP ratio of about 30 percent in 2007. The gap becomes even wider when one compares the levels of credit going to non-state sector of the economy. As of March 2008, 74 percent of all loans were short term with average interest rates of 12.7 percent. The loans per capita ratio in Belarus of US$ 415 is much lower than in other neighboring countries, compared to US$939 in Russia and US$1,370 in Kazakhstan. The level of per capita deposits is also low at $1,129 per capita, with 85 percent of total deposits concentrated in majority state-owned banks. Finally, the penetration of ATMs and branches of financial institutions is below the level of neighboring countries.

8. **The expansion of the MSME sector is crucial for the national economy, although it is impeded by the burdensome (albeit improving) regulatory framework and the uneven playing field created by the large state enterprises.** In Belarus, the MSME sector will be particularly important for enhancing the competitiveness of the national economy as the state-owned enterprise sector undergoes privatization and restructuring. However, the micro, small and medium enterprises currently employ about 25 percent of the economically active population and generate around 10 percent of GDP. The overwhelming majority of MSMEs operate in Minsk and Oblast centers. Given the potential of the MSME sector, the government has targeted to increase MSME share of GDP to 20 percent by 2010. The current regulatory regime could be made more conducive for MSME lending. The NBRB may consider modifying its ceiling for microloans. Contract enforcement is strong (ranked as 14th globally in the 2009 Doing Business report), but serious barriers remain to the foreclosure of personal residences taken as collateral, and the use of non-tangible financial assets as collateral. Also, the bankruptcy legislation needs to ensure that secured creditors have clear priority rights to their collateral.

9. **Although several banks have been expanding credit to the MSME sector, the scope of these operations remains small and needs to be further developed.** The most active banks working with the MSME sector are private, mostly with foreign capital. Building on their successful experience with donor-financed credit lines (above all EBRD’s Micro lending Program), these banks offer an array of products to MSMEs. However, the program is able to serve only a small fraction of Belarusian entrepreneurs (around 2 percent by a recent estimate), and the cost of these resources remains high, especially due to the scarcity of long-term funding. The provision of MSME loans in the regions is much weaker than in Minsk, suggesting individual entrepreneurs and micro-enterprises are underserved. A recent survey conducted in Minsk found that 64 percent of entrepreneurs wish to receive financing from the bank, while another survey has estimated the same ratio at 88 percent nationwide. Informal finance is making up for the relative dearth of formal supply, at a high cost to entrepreneurs.

10. **Although the credit registry at the NBRB will be expanded in 2009, in the medium term a private credit bureau should be established.** The registry will start collecting and sharing information on all borrowers, while now only a limited amount of
data is collected for loans over an equivalent of US$10,000. The creation of a privately-operated credit bureau with comprehensive coverage (i.e., including also non-financial data) is encouraged in the medium term.

11. **Leasing companies represent the only type of non-bank institution, offering financial services in noticeable volumes.** In common with many other CEE economies, leasing sector has expanded rapidly in recent years, with the total volume of new operations reaching 1.9 percent of GDP at the end of 2007, up by 44 percent from 2006. Some 70 entities were active in offering leasing services in 2007, with approximately one-third of the market controlled by leasing companies established by commercial banks. As leasing represents an important alternative to lending to MSMEs and households without collateral, it is recommended that the authorities maintain the favorable VAT tax regime for the sector and consider changing the existing legislation to allow leasing to individuals.

12. **Given the low level of financial penetration, there is a large potential for developing alternative forms of retail and credit services for MSMEs and households.** The limited availability of long term credits may be expanded through attracting additional donor resources for on-lending to enterprise sector through qualified commercial banks. The present legislation limits the provision of credit services to fully licensed banks. The authorities formed a Working Group on the development of microfinance sector, which may lead to changes in legal framework to facilitate the establishment of specialized institutions to provide MSME loans to more borrowers. An extensive and well-maintained post office network presents the potential for improving access to financial services in small towns and rural areas.

**VII. FINANCIAL SYSTEM INFRASTRUCTURE**

**A. Payment Systems**

1. **The payment system architecture, which received high marks from the 2004 CPSIS assessment, has been improved further.** In 2008 all inter-bank payments were being gradually transferred to the Belarusian Inter-bank Settlement System (BISS), which is a Real Time Gross Settlement (RTGS) system. As part of this transfer, payment fees have been decreased and the number of staff reduced.

**B. Accounting, Financial Reporting and Auditing**

2. **The first report of Accounting and Auditing Report on the Observance of Standards and Codes (A&A ROSC) conducted in parallel to the FSAP update found some progress made since the 2004 FSAP.** The legislative framework, including standards, governing accounting and audit in Belarus has recently been significantly updated, although it needs to be improved to conform to international standards. For
example, there is no current requirement for statutory financial statements to be compliant with IFRS. IFRS-compliant statements for banks and thirty large commercial entities will be required (in addition to statutory reporting) to prepare IFRS-based financial statements starting in 2009. This will require significant training and education for financial statement preparers, auditors, civil servants and regulators. The basic enforcement mechanisms are in place with regards to auditing, including the state oversight. However, as financial statements are not publicly available, market discipline is missing.

3. **Anti-Money Laundering and Combating the Financing of Terrorism.** The legal framework for the AML/CFT has undergone several key changes. A revised Law on AML/CFT became effective in March 2006, and an NBRB instruction for banks and non-bank financial institutions was passed in February 2008. The instruction sets out, *inter alia*, criteria for the organization of internal controls, staff qualification and responsibilities, and know-your-customer requirements. The NBRB hosts periodic seminars for banks, provides methodological assistance, and has entered into cooperative agreements with several other central banks. The Department of Financial Monitoring within the Committee of State Control carries out the responsibilities of the Financial Intelligence Unit (FIU) of the Republic of Belarus. An AML/CFT assessment was conducted in Belarus by the Eurasia Group in August 2008, which was not available at the time of the FSAP update.
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